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In the Supreme Court of the United States

OCTOBER TERM, 1993

INTEL CORPORATION, PETITIONER

v.

ULSI SYSTEM TECHNOLOGY, INC., RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

The Federal Circuit's sharply divided ruling in this case has been widely publicized as a ground-breaking decision with far-reaching implications. We showed in the petition that the decision fundamentally misconceived an important issue of patent law. We also explained the substantial economic effects that follow from the lower court's distortion of the patent exhaustion doctrine, opening up a broad range of licensed patents to exploitation by opportunistic imitators. Ignoring the two dissenting opinions below, all of the commentary on this case, and all of our arguments on the merits, however, ULSI's brief in opposition insists that this is a routine case heavily dependent on idiosyncratic facts.

ULSI cannot avoid the obvious simply by clenching its eyes shut. Judges and commentators agree that the case has broad implications as a matter of patent law, for, as ULSI itself once admitted, this case turns on the law of patents, not contracts. It is beyond serious dispute that the outcome of this case, no matter who wins, will have a significant impact on how business is conducted in at least the semiconductor industry. The lower court's new twist on patent exhaustion rests on neither reason nor precedent, while the proper resolution of the issue will restore economic sense to this part of our intellectual property regime. The decision fully merits review by this Court.[1]

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[1] ULSI suggests in passing that the posture of this case (a reversal of a preliminary injunction) might make it inappropriate for review by this Court. Br. in Opp. 2 n.1. The Federal Circuit made clear, however, that it was ruling dispositively on questions of law. See Pet. App. 9a, 10a; see also Pet. 8 & n.3. ULSI also notes that the parties have entered into a conditional settlement that provides for royalty payments regardless of the outcome of this litigation but provides for a larger royalty if the preliminary injunction stands. This Court has repeatedly held that such conditional settlements do not undermine the necessity for or appropriateness of resolution by this Court of important issues of law. *Nixon* v. *Fitzgerald*, 457 U.S. 731, 743-744 (1982); *Havens Realty Corp.* v. *Coleman*, 455 U.S. 363, 370-371 (1982). If the Court is ever going to review the question presented by the petition, it is appropriate to do so in *this* case, and not to await some possible future case in which a party might have the fortitude to preserve this issue in litigation up through the Federal Circuit notwithstanding the definitive *ULSI* precedent.

1. To read the brief in opposition, one would think that this is an "easy case" (Br. in Opp. 3) in which the Federal Circuit, without dissent, corrected a painfully obvious error by the district court. In fact, a detailed panel dissent was followed by three judges' dissent from the denial of rehearing en banc, and both opinions persuasively explained that the sweeping rule of law announced by the panel majority is legally incorrect and practically important. Pet. App. 11a-23a, 40a-42a. The two district courts to consider the issue reached diametrically opposed conclusions. And the only circuit court to address the same issue before the creation of the Federal Circuit dismissed out of hand the rationale adopted in this case. See Pet. 2.

ULSI also pretends before this Court that the importance of this case is limited to "the precise wording of a given patent cross-license." Br. in Opp. 7. When the court of appeals issued its decision, ULSI's own spokesman was far more candid, announcing that the decision had "ramifications * * * for the entire semiconductor industry." *Intel, Clone Maker ULSI at Odds Over Federal Court Decision*, PC WK., July 5, 1993, at 106. Commentators from the intellectual property bar agreed that the Federal Circuit's "treatment of the doctrine of patent exhaustion has far reaching implications for a broad range of technologies." Martin, Intel Corp. v. ULSI System Technology, Inc.: *Patent Exhaustion and Post-Sale Restrictions on the Use of a Component Made Under License*, 2 TEX. INTELL. PROP. L.J. 5, 6 (1993). See also, *e.g.*, Hustein & Greguras, *Impact of the ULSI Case on High-Technology Industry*, S.F. DAILY J., Nov. 9, 1993, at 5 ("It cannot be over-emphasized that the ULSI case is not limited to semiconductors."); Hustein & Greguras, *Cross-License Agreements Can Circumvent Patent Infringement*, S.F. DAILY J., Nov. 8, 1993, at 5; Abramson, *When the Chickens Come Home to Roost: The Licensed Foundry Defense in Patent Cases*, COMPUTER LAW., Mar. 1993, at 1, 1 (noting "intense interest" and "considerable controversy" surrounding district court decisions).

2. Contrary to ULSI's assertions, the Federal Circuit's decision does not turn on the presence of "precise terms" (Br. in

Opp. 6) in the patent license agreement.[2] It rests on the *absence* of language that *prevents* the licensee from performing fabrication services for third parties. Pet. App. 7a-10a. The patent license agreement is relevant only to the extent that it imposes "no restriction on HP's right to sell or serve as a foundry" (Pet. App. 10a), but that "right to sell" matters only if the ULSI/HP transaction is a "first sale." All licensed patents are open to predation unless the terms of the license reflect that the patentee clearly "retained its right to proceed against those who entered into foundry agreements such as the present one." Pet. App. 8a.[3] Those are rules of patent law determining the rights of the patent holder vis-à-vis the imitator; like all rules determining the relative rights of private parties, they can be altered by contract, but that fact hardly makes them into mere rules of contract law. See also Pet. 23 n.10; *Keeler* v. *Standard Folding Bed Co.*, 157 U.S. 659, 666 (1895).

ULSI's attempt to repackage the issues in this case as matters of contract is of strikingly recent vintage. ULSI successfully

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[2] ULSI mischaracterizes this patent dispute between Intel and ULSI as a contractual dispute between HP and Intel. Br. in Opp. 4 ("Intel sought to narrow the effective scope of its earlier patent cross-license with HP by bringing this action"). Intel has no quarrel with HP, does not object in the least to HP's performance of foundry services, and has no desire to alter its agreement with HP. Intel asserts only that the performance of foundry services by HP for an infringer of an Intel patent does not have the *legal effect* of relieving the infringer – ULSI – of responsibility for its imitative activity. Of course, ULSI, like every infringer, asserts that it is "pro-competitive" to ignore Intel's patent. Br. in Opp. 1. But the patent laws *do* stifle competition – competition from those who choose to imitate rather than innovate – in order to provide a proper incentive for inventors.

[3] Contrary to ULSI's perception of the HP license as somehow unique, it is typical for patent licenses *not* to include an anticipatory repudiation of the rule announced below. For example, in the pending case of *Cyrix Corp.* v. *Intel Corp.* v. *Texas Instruments, Inc.*, No. 4:92cv52 (E.D. Tex.), Intel's cross-licenses with Texas Instruments and SGS-Thomson are alleged to give rise to the "licensed foundry" defense announced in *ULSI*.

insisted below that "sale by a licensed foundry, unless otherwise restricted in the license, is a 'first sale.'" C.A. Reply Br. 9. ULSI argued that, unless that broad premise of patent law were valid, "there would have been no reason" for the court of appeals in *Intel Corp.* v. *ITC*, 946 F.2d 821 (Fed. Cir. 1991) (*Atmel*), "to address the more difficult and fact-specific inquiry" into the meaning of the patent license agreement. *Ibid.*

Only because of its important (and erroneous) holding of patent law did the Federal Circuit majority devote any of its attention to interpreting a contract, and the contract it interpreted was not the Intel/HP license agreement.[4] The majority thought that this case "turns on whether there was a sale of 'C87 coprocessors by HP to ULSI" (Pet. App. 6a) and sought to resolve that issue by interpreting the *ULSI/HP foundry services agreement*. Whether there was a "sale" of the sort that allows ULSI to "resell" with impunity otherwise-infringing products, however, should turn on the rationale and scope of the first-sale doctrine of patent law, not on the terms of a contract to which the patent holder is not a party. The majority's error was not misinterpreting a contract, but misinterpreting patent law. See Pet. App. 15a (panel dissent).

Ironically, ULSI tries to hide behind the characterization of the transaction as a "sale" in the ULSI/HP agreement at the same time that it quotes (Br. in Opp. 12) the observation in *United States* v. *Masonite Corp.*, 316 U.S. 265, 278 (1942), that "this Court has quite consistently refused to allow the form into which the parties chose to cast the transaction to govern." As we

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[4] The panel dissent observed that the evidence indicated "unequivocally" that neither HP nor Intel intended their agreement to shield third parties like ULSI (Pet. App. 19a), and the majority did not dispute the dissent on that point, which of course would be critical if this case turned on interpretation of the Intel/HP contract. Rather than treating this as a case in which the intent of the parties to *that* contract mattered, however, the majority insisted that the *only* thing that mattered was whether HP "sold" the chips to ULSI. Pet. App. 6a-8a. Thus, to determine the rights of *Intel*, the majority looked to the intent of *HP and ULSI* in framing *their* contract, not the Intel/HP contract as ULSI contends.

explained in the petition (at 19-20), the *substance* of the ULSI/HP transaction is that of author (ULSI) and custom printer (HP). If the author's work illicitly copies another, it is absurd to contend that the printer's license to print the other work somehow protects the author as well. The printer does not sell the author his work, though the printer does demand payment for the printed volumes.

To reach the contrary conclusion, the Federal Circuit merely seized on the caption of the ULSI/HP contract to determine that in some sense the agreement was a "sale." Pet. App. 7a. In the lower court's view, if HP sold ULSI anything, the transaction must exhaust Intel's patent. That conclusion is insupportable. The patent laws do not protect factory labor or raw materials, but rather the invention – the intellectual property – embodied in an article. A "sale" cannot dissipate patent rights unless the invention subject to the patent has been sold. As we demonstrated (Pet. 23-25), HP did not sell the invention embodied in ULSI's chips to ULSI, any more than would a delivery driver who dropped the chips at ULSI's loading dock C.O.D. HP did not own ULSI's infringing invention; it could not copy ULSI's infringing invention; it could not sell ULSI's infringing invention; and it did not legitimate ULSI's infringing invention. ULSI provides no coherent response to these points.

3. From ULSI's pious pronouncement about "overruling or modifying * * * prior cases," one would think that Intel had explicitly asked this Court to overrule *United States* v. *Univis Lens Co.*, 316 U.S. 241 (1942). See Br. in Opp. 10. In fact, Intel pointed out (Pet. 25-28) the compelling reasons why *Univis Lens* does not support (but actually undercuts) the decision below.[5] ULSI completely ignores those reasons.

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[5] ULSI cites (Br. in Opp. 10) *Deepsouth Packing Co.* v. *Laitram Corp.*, 406 U.S. 518 (1972) (rejecting extraterritorial application of 35 U.S.C. § 271(a)), but it is unclear how *Deepsouth* pertains to this case, except that the decision below, more than *Deepsouth*, promises "unduly to reward the artful competitor who uses another's invention * * * and who seeks to profit thereby." *Id.* at 532-533 (Blackmun, J., dissenting).

This Court said in *Univis Lens* that the kind of sale necessary to "exhaust" a patent is "the vehicle for transferring to the buyer ownership of the invention with respect to that article" (316 U.S. at 252) and that patent exhaustion occurs only when there has been "a complete transfer of ownership" of an article that is "within the protection of the patent law" (*id.* at 249). Both statements clearly distinguish *Univis Lens* from this case, but ULSI ignores these important limitations on the holding of *Univis Lens* and treats ownership as irrelevant. Br. in Opp. 8-9 & n.4.[6] Under a proper reading of *Univis Lens*, however, ownership is critical: HP could not sell what it did not own. See Pet. 25.

Although there was a physical transfer of a product in this case, the resemblance to *Univis Lens* stops there. In *Univis Lens*, the "buyer" did not already own the design of the article sold, and the reasoning in that case makes quite clear that the ownership of the *invention* lies at core of the patent exhaustion doctrine. No invention changed hands in this case. Far from asking this

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[6] Understandably lacking the courage of its convictions, ULSI also asserts that HP *did* own the math coprocessors and therefore *did* transfer ownership when it "sold" them to ULSI. Br. in Opp. 9 n.4 ("Intel simply is wrong in suggesting that HP did not 'own' the [ULSI] chips"). But that assertion appears for the very first time in this Court. ULSI made no effort in the district court to dispute an HP representative's sworn testimony that "HP has no ownership rights to ULSI's products." C.A. App. A413. Relying on that affidavit, the district court observed that HP "never assumed any ownership rights in any ULSI product and had no right to use or sell any ULSI product." Pet. App. 36a n.7. ULSI did not challenge that observation on appeal, the panel majority did not take issue with it, and the panel dissent specifically agreed with it (Pet. App. 21a-22a). In any event, ULSI's new-found claim that HP owned ULSI's chips is preposterous. See Pet. 24-25. ULSI's definition of ownership apparently does not include one of the most important sticks in the bundle of property rights: the right to convey the property to others. Br. in Opp. 9 n.4 ("Whether or not HP would then have been free to sell those chips to another buyer is irrelevant."). Like a lawyer's "retaining lien" or ability to retain his client's papers and other property until he receives his fee (see 7A C.J.S. *Attorney & Client* § 358 (1980)), HP's ability to keep the math coprocessors if ULSI did not pay for them reflected a security interest, not ownership.

Court to overrule *Univis Lens*, we ask the Court for a thoughtful application of that case – and other cases applying the first-sale doctrine in a patent infringement context rather than the antitrust context of *Univis Lens* – to an emerging and controversial tactic for dodging patent infringement claims.

4. ULSI also pretends to believe that Intel's theory is "unprecedented" and that the applicability of the first-sale doctrine to the facts of this case is so clear that no one could possibly question it. In fact, application of the first-sale doctrine to facts like these was rejected long ago in *Timken* v. *Olin*, 41 F. 169, 171 (C.C.S.D. Ohio 1890), was rejected by the district court in this case (Pet. App. 34a-36a), and is so controversial that the issue has prompted not only sharp differences of judicial opinion but also a spate of articles, both before and after the decision below, all trumpeting the profound implications of that novel decision. See articles cited at p. 2, *supra*. See also Orenstein, *Chip Makers Given New Defense Against Infringement Claims*, THE RECORDER (S.F.), June 15, 1993, at 1.

ULSI decries the supposed threat to "commercial certainty" (Br. in Opp. 3) posed by a rational interpretation of the first-sale doctrine in the foundry context. As the three judges dissenting from denial of rehearing en banc pointed out, it is the decision below that "frustrates * * * reasonable commercial expectations, and destroys important property rights * * * under the patent laws" as well. Pet. App. 41a. ULSI ignores the fact that for one hundred years the *only* authority on a foundry arrangement of this kind had summarily rejected ULSI's position. *Timken* v. *Olin*, *supra*. In the intervening century, it seems, no one was bold enough to advance the argument embraced by the current crop of computer chip imitators. To the extent that there was commercial certainty, it was the certainty that one could not launder one's infringing product by hiring a licensee to manufacture it.[7]

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[7] As a corollary to its pretense that Intel's position would overturn "well-settled" law, ULSI attempts through a series of hypothetical questions to show that Intel's position "would complicate enormously the heretofore straightforward patent exhaustion doctrine." Br. in Opp. 12. Whatever complexities may inhere in complex hypothetical situations,

In fact, the decision below is the first appellate case *ever* to excuse patent infringement by applying the first-sale doctrine to a patent laundering arrangement. Not until the Federal Circuit included certain dicta in its *Atmel* decision (ruling in favor of the patentee) in 1991 had any court even hinted that the patent exhaustion doctrine might be a device for opportunistic imitators to avoid paying for the use of a patent; not until the district court decision in *Cyrix Corp.* v. *Intel Corp.*, 803 F. Supp. 1200 (E.D. Tex. 1992), appeal pending, No. 93-1573 (Fed. Cir.), did any court hold that a laundering arrangement actually exhausted a patent. The supposed "certainty" that ULSI asks this Court to respect dates at the earliest from June 1993, when the panel decision below resolved the conflict between recent district court opinions.

Still more tellingly, neither ULSI nor the Federal Circuit identified *a single case* in which a so-called "sale" was held to have exhausted patent rights even though the purchaser had supplied the design function, the invention, the intellectual property. ULSI's adamant insistence that the ownership of the design was not determinative in this Court's prior cases is wholly irrelevant because the issue simply was not presented. In *none* of those cases was the design function performed by anyone other than the patentee or licensee, and there was no reason for the courts to anticipate such an arrangement. The first-sale doctrine has *always* been applied to protect innocent purchasers who had nothing to do with the intellectual property involved, except that they wanted to use or to sell a patented article that they had bought. Not until this case (and the district court decision in *Cyrix*) has the first-sale doctrine been misapplied to protect unlicensed commercial imitators of patented products.

5. ULSI ironically complains that to apply the first-sale doctrine to foundry agreements as we propose would "regulate form

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however, there is nothing particularly intricate about this case. ULSI designed a math coprocessor that infringes an Intel patent, and it sought to evade the patent law by having an Intel licensee, HP, manufacture its infringing product. A desire to avoid complexity is no justification for blessing that blatant scheme.

rather than substance." Br. in Opp. 11. As we explained in the petition (at 19-25), the decision below truly ignored substance in favor of form: the court of appeals relied on the fact that the "Agreement [for] fabrication of an integrated circuit designed by ULSI" (C.A. App. A38) was *captioned* a "sale." Pet. App. 7a.

ULSI also suggests that parties could "circumvent" a decision in Intel's favor. Br. in Opp. 11-12. It is scarcely news that parties will adjust to whatever rule of law governs an economic relationship. See generally Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

But ULSI is quite wrong to suggest that a transfer of the design to the patent licensee produces a transaction that is "identical in substance to the sale at issue in this case." Br. in Opp. 11.[8] On the contrary, in both economic and legal significance that transaction is substantially *different* from the transaction in this case. Most critically, the licensee (HP) would own the invention that it fabricated and sold to the purchaser. The imitating designer then would have to bargain for – and pay for – the privilege of using the licensed patent rights. It would be quite clear that the imitator sought the licensee's ability to provide protection from infringement lawsuits, protection for which the imitator likely would have to pay dearly if it wanted to use a valuable patent. In this case, by contrast, it is clear that ULSI successfully hid from HP its intention to benefit from HP's patent rights. See Pet. 7; C.A. App. A411. Moreover, there would be an important legal consequence if HP became the owner of ULSI's design: any intellectual property rights inhering in that design would automatically be shared with Intel under the Intel/HP patent license. Under the existing arrangement and the

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[8] ULSI's other example (Br. in Opp. 11) – "licens[ing] its 'design' to the [licensed] foundry [HP] for the [exclusive] purpose of manufacturing the desired article" – would *not* amount to a transfer in ownership of the design and would *not* exhaust Intel's patent rights for the reasons amply explained in the petition (at 19-29).

Federal Circuit's holding, by contrast, ULSI gets the benefit of Intel's patent while sharing *nothing* with Intel.[9]

Much as ULSI would like this Court to believe otherwise, this case is not *Univis Lens*; the sharply divided opinions below do not reflect the routine application of established law; and this highly publicized case does not present a narrow, fact-dependent issue. This case presents a novel issue of substantial importance, and the decision below rewards imitators and punishes America's innovators for no sufficient reason.

For the foregoing reasons and those given in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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[9] ULSI asserts that Intel has received its "just reward" from the HP/Intel agreement, and that therefore ULSI should have the same design freedom for which HP bargained and paid. Br. in Opp. 8. Yet ULSI has paid no price to anyone for the use of Intel's patent. See Hustein & Greguras, *supra*, S.F. DAILY J., Nov. 9, 1993, at 5. Surely Intel received no reward whatsoever for ULSI's infringing coprocessor.